

# Scottish Funding Council

2020/21 Annual Audit Report



 AUDIT SCOTLAND

Prepared for the Scottish Funding Council and the Auditor General for Scotland

August 2021

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# Contents

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Key messages	3
Introduction	4
1. Audit of 2020/21 annual report and accounts	6
2. Financial management	10
3. Financial sustainability	13
4. Governance and transparency	15
5. Value for money	17
Appendix 1. Action plan 2020/21	20
Appendix 2. Significant audit risks	25
Appendix 3. Summary of 2020/21 national performance reports	28

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# Key messages

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## 2020/21 annual report and accounts

- 1 The financial statements of the Scottish Funding Council (SFC) give a true and fair view of its financial position at 31 March 2021 and its net expenditure for 2020/21.
- 2 The expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance.
- 3 The other information in the annual report and accounts is consistent with the financial statements and prepared in accordance with legal requirements.

## Financial management and sustainability

- 4 SFC has appropriate and effective arrangements for financial management. It operated within budget and reported an underspend of £0.3 million for 2020/21.
- 5 Systems of internal control operated effectively in 2020/21, and SFC has appropriate arrangements for the prevention and detection of fraud and error.
- 6 SFC issued £190 million of Covid-19 related funding in 2020/21 which helped stabilise the short-term financial position of colleges and universities. Further work is required to evaluate the impact of Covid-19 on the sectors' longer-term finances.

## Governance, transparency and value for money

- 7 Governance arrangements are appropriate and support effective oversight of SFC's activities and finances.
- 8 The performance report meets the requirements, with scope for further improvements.
- 9 SFC has an appropriate and effective Best Value framework in place.
- 10 Reporting to the board on performance in the college and university sectors has been delayed. As a result, it has yet to assess the impact of Covid-19 on the sectors' performance.

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# Introduction

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**1.** This report summarises the findings from our 2020/21 audit of the Scottish Funding Council (SFC).

**2.** The scope of our audit was set out in our Annual Audit Plan (AAP) presented to the 5 March 2021 meeting of the Audit and Compliance Committee. This report comprises the findings from:

- an audit of SFC's annual report and accounts
- consideration of the four audit dimensions that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#).

**3.** The main elements of our audit work in 2020/21 have been:

- an audit of SFC's 2020/21 annual report and accounts, including the issue of an independent auditor's report setting out our opinions
- a review of SFC's key financial systems
- consideration of the four audit dimensions.

**4.** The global coronavirus pandemic has had a considerable impact on the finances of the colleges and universities which SFC funds. Risks related to the pandemic were included in our AAP, and we have adapted our planned audit work to review SFC spending on Covid-19 initiatives.

## Adding value through the audit

**5.** We add value to SFC through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations
- sharing intelligence and good practice through our national reports ([Appendix 3](#)) and good practice guides
- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

## Responsibilities and reporting

**6.** SFC has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts that are in accordance with the accounts direction from the Scottish Ministers.

- 7.** SFC is also responsible for establishing appropriate and effective arrangements for governance, propriety and regularity.
- 8.** Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice 2016](#), and supplementary guidance and International Standards on Auditing in the UK. As public sector auditors we give independent opinions on the annual report and accounts.
- 9.** Additionally, we conclude on the appropriateness and effectiveness of the performance management arrangements, the suitability and effectiveness of corporate governance arrangements, the financial position and arrangements for securing financial sustainability.
- 10.** Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.
- 11.** This report raises matters from our audit. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control.
- 12.** Our annual audit report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, the responsible officers and dates for implementation. It also includes any outstanding actions from last year and progress against these.

## Auditor independence

- 13.** Auditors appointed by the Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must also comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies.
- 14.** We can confirm that we comply with the Financial Reporting Council's Ethical Standard and we have not undertaken any non-audit related services. We are not aware of any relationships that could compromise our objectivity and independence.
- 15.** We completed additional work in response to a new requirement to audit the Scottish colleges whole of government accounts. Our audit fee for this work was £1,972. This increased the 2020/21 audit fee of £75,790, as set out in our AAP, to £77,762.
- 16.** This report is addressed to both SFC and the Auditor General for Scotland and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) in due course.
- 17.** We would like to thank the management and staff who have been involved in our work for their cooperation and assistance during the audit.

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# 1. Audit of 2020/21 annual report and accounts

The principal means of accounting for the stewardship of resources and performance

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## Main judgements

The financial statements of SFC give a true and fair view of its financial position at 31 March 2021 and its net expenditure for 2020/21.

The expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

The other information in the annual report and accounts is consistent with the financial statements and prepared in accordance with legal requirements.

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## Our audit opinions on the annual report and accounts are unmodified

**18.** The annual report and accounts for the year ended 31 March 2021 were approved by the SFC Board on 2 September 2021. As reported in the independent auditor's report:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- expenditure and income were regular and in accordance with applicable enactments and guidance
- the Performance Report, the Governance Statement and the audited part of the Remuneration and Staff Report were all consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

## The audit of the 2020/21 annual report and accounts was completed in line with the agreed timetable

**19.** SFC and Audit Scotland staff continued to work from home for the duration of the audit. We kept in regular communication with management throughout and, despite the challenges of remote working, the audit was completed in line with the planned timetable.

**20.** We received the unaudited annual report and accounts and working papers package in line with our agreed audit timetable on 7 June 2021. SFC achieved this alongside administering additional funding to help support further and higher education respond to the impact of Covid-19.

**21.** The annual report and accounts were generally of an acceptable standard but some sections were incomplete and a key working paper relating to financial transactions was only made available to us after the audit commenced. The audit team received support from finance staff which helped ensure the audit ran smoothly.

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## Recommendation 1

SFC should introduce additional steps to ensure the accounts presented for audit and the related working papers are complete.

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## Accounting framework

**22.** An addendum to the 2020/21 Government Financial Reporting Manual (FRoM) was issued in response to the impact of Covid-19 and sets out minimum reporting requirements. A similar addendum was issued last year.

**23.** The addendum permits, but does not require, bodies to omit the performance analysis section from the Performance Report. Where relevant performance information has already been published elsewhere, bodies are encouraged to refer to the relevant publication.

**24.** SFC has again used this dispensation and the 2020/21 annual report and accounts does not have a performance analysis section. The performance summary provides a high-level overview of performance for the year.

## Overall materiality is £21.6 million

**25.** Our initial assessment of materiality was carried out during the planning phase of the audit. This was reviewed on receipt of the unaudited annual report and accounts and is summarised in [Exhibit 1](#).

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### Exhibit 1 Materiality values

Materiality level	Amount
Overall materiality	£21.6 million
Performance materiality	£16.2 million
Reporting threshold	£250,000

Source: Audit Scotland

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## Appendix 2 identifies the main risks of material misstatement and our audit work to address these

26. [Appendix 2](#) provides our assessment of risks of material misstatement in the annual report and accounts and any wider audit dimension risks. These risks influence our overall audit strategy, the allocation of staff resources to the audit and indicate how the efforts of the audit team were directed. [Appendix 2](#) also identifies the work we undertook to address these risks and our conclusions from this work.

## Significant findings to report on the annual report and accounts

27. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of SFC's accounting practices.

28. The significant findings are summarised in [Exhibit 2](#). Where a finding has resulted in a recommendation to management, a cross-reference to the Action Plan in [Appendix 1](#) has been included.

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### Exhibit 2

#### Significant findings from the audit of financial statements

Issue	Resolution
<p><b>1. Financial transactions – accounting</b></p> <p>The annual report and accounts provided for audit did not reflect the adoption of International Financial Reporting Standard 9, Financial Instruments. IFRS 9 specifies how an entity should classify and measure financial assets and financial liabilities.</p> <p>SFC assessed the impact and concluded that the IFRS 9 adjustments and disclosures for its financial transaction balances is not material in the context of its accounts. On this basis, it did not apply IFRS 9 in preparing its accounts.</p>	<p>We confirmed that accounting for IFRS 9 would not have a material impact on the 2020/21 annual report and accounts.</p> <p>Management has agreed to review its accounting policy for financial transactions annually and assess whether to apply IFRS 9 in future.</p> <p><b>Recommendation 2</b> (refer <a href="#">Appendix 1</a>, action plan)</p>
<p><b>2. European Social Fund income – accounting</b></p> <p>SFC is a lead partner for two European Social Fund (ESF) programmes: the Youth Employment Initiative (YEI) and Developing Scotland's Workforce (DSW). SFC provides funding to colleges to support these programmes and claims matched European funding through the Scottish Government. The YEI programme has now ended but claims are outstanding.</p>	<p>We have confirmed that accounting for ESF income on a cash basis does not have a material impact on the 2020/21 annual report and accounts.</p> <p>In our view, SFC's accounting treatment of ESF income is no longer appropriate due to the increased number of claims approved. The amount received in July 2021 was not accrued in the 2020/21 accounts and income for the year and</p>

Issue	Resolution
<p>SFC's accounts are prepared on an accruals basis but it continues to account for ESF income on a cash basis. This is because in SFC's view the timing and receipt of this income is uncertain.</p> <p>In 2020/21 SFC received £2.3 million of ESF income. In July 2021, SFC received a further £2.6 million for a 2017/18 DSW claim.</p>	<p>the Statement of Financial Position is therefore understated by £2.6 million.</p> <p>Management has agreed to carry out an annual assessment of the accounting treatment of ESF funding to ensure it is in accordance with the FReM.</p> <p><b>Recommendation 3</b></p> <p>(refer <a href="#">Appendix 1</a>, action plan)</p>

Source: Audit Scotland

**29.** There are no material adjustments to the unaudited financial statements arising from our audit. There is one unadjusted error in the accounts that relates to ESF income (see [Exhibit 2](#)).

**30.** It is our responsibility to request that all misstatements, other than those below the reporting threshold, are corrected. The final decision on making the correction lies with those charged with governance considering advice from senior officers and materiality.

**31.** Management do not propose to adjust for the item above as the amounts are not considered material in the context of the financial statements.

## SFC has made progress on prior year recommendations

**32.** SFC has made progress in implementing our prior year audit recommendations. For actions not yet implemented, revised responses and timescales have been agreed with management and are set out in [Appendix 1](#).

## 2. Financial management

Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

### Main judgements

SFC has appropriate and effective arrangements for financial management. It operated within budget and reported an underspend of £0.3 million for 2020/21.

Systems of internal control operated effectively in 2020/21, and SFC has appropriate arrangements for the prevention and detection of fraud and error.

SFC issued £190 million of Covid-19 related funding in 2020/21 as part of overall funding of £1.9 billion.

### SFC operated within budget in 2020/21

**33.** The main financial objective for SFC is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers.

**34.** SFC's budget management process is complex, with the application of a financial year budget to an academic year along with the need to manage budget pressures and commitments. SFC manages its budget through an annual re-profiling exercise to allocate funds among the further education, higher education, and running costs budget.

**35.** SFC's financial performance against Departmental Expenditure Limits (DEL) is shown in [Exhibit 3](#). SFC underspent its overall budget by £0.3 million.

### Exhibit 3

#### Performance against DEL in 2020/21

Performance	Final budget £m	Outturn £m	Over/(under) spend £m
Resource DEL	1,606.8	1,606.4	(0.4)
Capital DEL	478.1	478.2	0.1
Financial transactions	55.0	55.0	-
Total DEL	2,139.9	2,139.6	(0.3)

Source: Scottish Funding Council resource return

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## **SFC administered additional funding to help support further and higher education respond to the impact of Covid-19.**

**36.** During 2020/21 the Scottish Government announced an additional £190 million non-recurring Covid-19 funding for colleges and universities. Major areas of additional funding issued by SFC included:

- £75 million research funding allocation for universities
- £40 million resource funding to help colleges and universities maintain research activity, protect jobs, and help students
- £20 million additional capital funding for colleges and universities to boost research and knowledge exchange.

**37.** SFC administered Covid-19 funding using the same systems and processes as it applies for other grants.

## **Financial systems of internal control operated as expected**

**38.** We identify and assess the key internal controls in those accounting systems which we regard as significant to produce the financial statements. Our objective is to gain assurance that SFC has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

**39.** We tested key controls in the general ledger and grant distribution systems to confirm they were operating as expected. Where possible we placed reliance on the work of internal audit.

**40.** We found that, overall, controls were operating as expected. We identified one area where general ledger controls could be strengthened. Our testing confirmed that management review general ledger access rights once a year. We recommend that senior officers review this more regularly to ensure access to the system is restricted to appropriate staff.

**41.** We also followed up SFC's progress in addressing the three control weaknesses identified in our 2019/20 management report. All three prior year recommendations have now been addressed.

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## **Recommendation 4**

**SFC should ensure senior officers review access to the general ledger on a more regular basis throughout the year.**

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## **Internal audit**

**42.** SFC's internal audit function is provided by a shared service arrangement with Scottish Enterprise, Skills Development Scotland, and South of Scotland

Enterprise. Each year we consider whether we can rely on internal audit work to avoid duplication of effort.

**43.** We reviewed SFC's internal audit arrangements in accordance with International Standard on Auditing (UK) 610 (Using the Work of Internal Auditors) to determine the extent we could rely on the work of internal audit. We placed reliance on internal audit's work on key financial controls and grant funding distribution. We also reviewed a range of other internal audit reports to inform our wider dimension audit work.

## Workforce capacity

**44.** We have previously reported on staff capacity and the need for SFC to ensure adequate resources to carry out its core functions, and meet the objectives set out in its strategic plan.

**45.** SFC acknowledged the need to reorganise and build capacity. It obtained Scottish Government approval to a voluntary exit scheme and during the year eight employees left through the scheme. The savings achieved will allow SFC to bring in new skills and capabilities.

**46.** SFC faces additional demands on its resources to help manage risks to the financial sustainability of colleges and universities. It has created two new deputy director roles in finance to build resilience in this area. Overall, SFC is working to ensure it has sufficient capacity to deliver its objectives and aims to fill the vacant posts in its new structure during 2021/22.

## Standards of conduct and arrangements for the prevention and detection of fraud and error are appropriate

**47.** SFC is responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery, and corruption. It is also responsible for ensuring that its affairs are managed in accordance with proper standards of conduct by putting effective arrangements in place.

**48.** We reviewed the arrangements to maintain standards of conduct, including the Staff Handbook and Civil Service and Members' Codes of Conduct. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

**49.** The National Fraud Initiative (NFI) is a counter-fraud exercise across the UK public sector which aims to prevent and detect fraud. SFC has investigated and closed all the matches that it received in the 2020/21 exercise.

**50.** Overall, we concluded that SFC has appropriate arrangements for the prevention and detection of fraud, error, and irregularities.

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# 3. Financial sustainability

Financial sustainability looks to the longer-term to consider whether a body is planning effectively to continue to deliver its services

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## Main judgements

The additional funding distributed by SFC during Covid-19 helped stabilise the short-term financial position of colleges and universities. Further work is required to evaluate the impact of Covid-19 on the sectors' longer-term finances.

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### SFC continues to support colleges and universities in managing the financial risks associated with Covid-19

**51.** Covid-19 has significant implications for the finances and operation of Scotland's colleges and universities, which are likely to continue for years to come. SFC has continued to support colleges and universities to help manage risks to financial sustainability. This placed additional demands on SFC and required it to re-prioritise activity and build capacity.

**52.** Covid-19 has increased the financial pressures and uncertainties which colleges and universities face. The college sector ended academic year 2019/20 with an adjusted operating surplus of £3.4 million. This was less than the £12.9 million adjusted operating surplus the previous year, but better than the forecast adjusted operating deficit of almost £10 million. The university sector's underlying operating surplus reduced from £91 million in 2018/19 to £43 million in 2019/20, which was in line with forecasts.

**53.** The full financial effects of Covid-19 were expected during academic year 2020/21. In the event, the financial position was stabilised through the distribution of additional funding by SFC, the Coronavirus Job Retention Scheme and the actions taken in individual institutions. The most recent forecasts, in early 2021, estimated an adjusted operating deficit of £0.5 million for the college sector and an underlying operating surplus of £155 million for the university sector.

**54.** SFC published two reports (October 2020 and June 2021) on the financial sustainability of colleges and universities, as part of its review of tertiary education and research. The reports provide a useful overview of the sectors' financial position (actual and forecast), action taken in response to Covid-19, and risks and challenges.

**55.** We would encourage SFC to continue to develop its reporting in this area, with a focus on longer-term financial sustainability and to support transparency and understanding of the financial position in these key sectors.

## SFC has called for multi-year funding commitments to support effective longer-term financial planning

**56.** Colleges and universities continue to operate within a tight financial environment. SFC recognises the challenges that colleges and universities face in managing short-term and non-recurring funding allocations.

**57.** Financial forecast returns from colleges and universities allow SFC to build a picture of the financial health of the sectors. This informs its own financial plans and in turn helps it to support colleges and universities effectively.

**58.** Returns usually include financial projections for the current academic year and following three years. The most recent returns have covered shorter periods, reflecting uncertainty over the longer-term impact of Covid-19. SFC plans further engagement with the Scottish Government and college sector about funding assumptions beyond 2021/22, before asking colleges to submit longer-term financial forecasts by October 2021.

**59.** The [final report](#) of SFC's review of tertiary education and research (June 2021) recommends that the Scottish Government sets out multi-year funding assumptions and commitments to help SFC and institutions undertake better strategic planning and secure greater impact.

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### Recommendation 5

SFC should continue working with colleges and universities to produce longer-term financial forecasts. It should use these forecasts and any multi-year funding assumptions and commitments from the Scottish Government to develop SFC's longer-term financial planning.

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# 4. Governance and transparency

Governance involves effective scrutiny and oversight, and transparent reporting of information

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## Main judgements

Governance arrangements are appropriate and support effective oversight of SFC's activities and finances.

The performance report meets the requirements, with scope for further improvements.

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## SFC has had appropriate governance and controls during the Covid-19 pandemic

**60.** The corporate governance framework within SFC centres on the board, supported in its role by seven committees including the Audit and Compliance Committee and the Finance Committee.

**61.** The impact of Covid-19 is reflected in the Governance Statement in SFC's annual report and accounts. We reported last year that board and committee meetings had been conducted remotely and this continues to be the case.

## The performance report met the statutory requirements

**62.** In addition to the opinion on the performance report covered in Part 1 of our Annual Audit Report, we also consider the qualitative aspects of SFC's performance reporting. This is an area of audit focus and we note the improvements which SFC has implemented in recent years.

**63.** The performance report should provide information on SFC's main objectives and the principal risks faced. It should provide a fair, balanced and understandable analysis of SFC's performance as well as helping stakeholders understand the financial statements.

**64.** SFC used the dispensation in the 2020/21 Financial Reporting Manual (FReM) and opted not to include a performance analysis in its annual report. The performance summary which is included meets the requirements. It provides high-level information on SFC's performance in 2020/21, including details on how funding was spent and information on the impact of Covid-19 on SFC and the college and university sectors.

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## Recommendation 6

SFC should resume its focus on the performance report to ensure it provides a comprehensive picture of how it has applied funds and what it has achieved.

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## **SFC needs to improve its cyber security arrangements**

**65.** Public bodies should have good provisions for managing data and monitoring information security. They should also have demonstrable capacity and capability to respond to increasing risks to cyber security. Threats are increasing as organisations deliver more service online.

**66.** Cyber security is highlighted within SFC's strategic risk register and the risk is owned by the Chief Information Officer (CIO). The CIO chairs SFC's IT Governance Board (ITGB) which is responsible for ensuring SFC's cyber security goals. The ITGB reports to SFC's Senior Leadership Group.

**67.** Internal audit issued an IT Risk Assessment report in December 2020 that identified this as an area of increasing risk. In response, SFC is progressing with Cyber Essentials Plus accreditation and penetration testing.

**68.** SFC received an external assessment in 2020/21 as part of the Cyber Essentials Plus accreditation process. The assessment identified some internal and external vulnerabilities. SFC is working to resolve the issues identified and will revisit this exercise during 2021/22. It is also planning further staff training to help improve cyber security awareness, further penetration testing and will introduce an IT risk register.

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## **Recommendation 7**

SFC should address the issues identified in the Cyber Essential Plus assessment and continue to work towards achieving this accreditation.

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# 5. Value for money

Using resources effectively and continually improving services

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## Main judgements

SFC has an appropriate and effective Best Value framework in place.

Reporting to the board on performance in the college and university sectors has been delayed. As a result, it has yet to assess the impact of Covid-19 on the sectors' performance.

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## SFC has developed an appropriate Best Value framework

**69.** [Ministerial guidance to Accountable Officers](#) for public bodies and the [Scottish Public Finance Manual](#) (SPFM) sets out the accountable officer's duty to ensure that arrangements are in place to secure Best Value.

**70.** The guidance sets out the key characteristics of Best Value and states that compliance with the duty of Best Value requires public bodies to take a systematic approach to self-evaluation and continuous improvement.

**71.** SFC assesses its compliance with the principles of Best Value by carrying out periodic self-assessment exercises. The self-assessment measures SFC against the Best Value characteristics an organisation should be able to demonstrate, as identified by the Scottish Government.

**72.** SFC has recently completed a self-assessment exercise and will report its findings to the Audit and Compliance Committee in August 2021.

## Covid-19 had an impact on performance reporting in 2020/21

**73.** A performance report is presented at most board meetings setting out SFC's progress against the planned activities in the operating plan. This focusses on the performance of SFC rather than the sectors.

**74.** An annual performance report is provided to the board summarising the performance of colleges, universities and the sectors using performance measures set out in the strategic framework document. This was due to be presented at the August 2020 board meeting but was postponed due to Covid-19. It has not yet been presented to the board.

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## Recommendation 8

SFC should ensure it reports regularly to the board on sector performance to enable effective scrutiny of college and university performance.

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## Advancing equalities

**75.** Public sector bodies must be able to demonstrate how they are fulfilling their duties under the Equality Act 2010. We have reviewed how SFC demonstrates its compliance with the Act, and how it advances equalities within the organisation and in its business activities.

**76.** SFC's Mainstreaming and Equality Outcome Report 2021-2025 was published in April 2021. The report sets out information on SFC's progress against the equality outcomes 2017-2021 including:

- Underrepresented groups in the workforce have been identified. As a result SFC has set a new equality outcome focused on making the necessary changes.
- SFC's Equality and Diversity group instructed a review of equality impact assessments in February 2019 to enhance transparency. A new equality outcome has been set for 2021-2025 to further improve SFC's approach to equality impact assessments.
- Data collection and processing is legally compliant. All data published on the SFC website is GDPR compliant.

**77.** SFC was the first public body in Scotland to develop a Memorandum of Understanding with the Equality and Human Rights Commission. The Memorandum, signed in March 2020, was designed to strengthen and reinforce compliance with Public Sector Equality Duties in engaging with colleges, universities and other funded bodies.

**78.** As part of the Memorandum of Understanding, SFC has committed to review equality outcomes set by the institutions which it funds. This work is due to be completed by September 2021.

**79.** Overall, our high-level review found that SFC complies with the specific duties of the Equality Act 2010. We concluded that SFC can demonstrate that equalities and diversity have a prominent place at the centre of its business.

## SFC has a key role in ensuring colleges and universities support social and economic recovery from Covid-19

**80.** Skills and training are central to the Scottish Government's Covid-19 economic recovery plans and its ambition for sustainable and inclusive economic growth. Increasing numbers of people may need skills support as the full impact of Covid-19 on employment and specific sectors of the economy becomes more apparent.

**81.** There is also a need to recruit and reskill the workforce to respond to the climate emergency and advances in digital innovation. SFC has a key role in ensuring that colleges and universities continue to make a significant contribution in supporting people into employment with the skills that individuals and businesses need.

**82.** One of the Enterprise and Skills Strategic Board's objectives is to align the skills planning roles of SFC and Skills Development Scotland. This work was initially led by a Joint Director of Skills Alignment (SDS and SFC) and the Skills

Alignment Assurance Group, which includes officials from SFC, is now taking this work forward.

**83.** As part of our national performance audit programme, Audit Scotland is undertaking a performance audit on [investing in skills](#) during 2021. This will assess how effectively SFC, Skills Development Scotland and the Scottish Government are working together to ensure the skills system responds to the current and future needs of people and businesses in Scotland.

**84.** The audit will examine the extent to which governance arrangements and strategic plans support an integrated approach to skills planning, how much is spent on skills provision, and the impact of Covid-19 on skills plans. Where appropriate, it will make recommendations to help support continuous improvement in the skills system. We expect to report later this year.

## **SFC has made recommendations to strengthen tertiary education and research**

**85.** In June 2020, Scottish Ministers commissioned SFC to review the provision and sustainability of further and higher education and research in Scotland, to address the challenges and opportunities brought by Covid-19. SFC published the [final report](#) on its review in June 2021.

**86.** The report includes a range of recommendations aimed at developing a more coherent, responsive and effective system of tertiary education and research. This includes calling for a clearer strategic longer-term vision for tertiary education and recommending changes to funding and delivery models and how outcomes are agreed and monitored.

**87.** Taking forward the recommendations will require collaboration between SFC, Scottish Government, colleges, universities, Skills Development Scotland and other partners. We will monitor how the SFC and others respond to the report recommendations and will report on this as appropriate.

## **National performance audit reports**

**88.** The Auditor General for Scotland published [Scotland's Colleges 2020](#) in May 2021, which highlights key findings from the 2019/20 accounts and annual audit reports of Scotland's incorporated colleges. The Auditor General noted that colleges continue to face financial challenges and that responding to the longer-term impact of Covid-19 will require change in the college sector.

**89.** A list of national performance reports published in 2020/21 is set out in Appendix 3, some of which may be of interest to SFC.

# Appendix 1. Action plan 2020/21

## 2020/21 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p><b>1. Submission of annual report and accounts for audit</b></p> <p>We received the unaudited annual report and accounts and working papers package in line with our agreed audit timetable. SFC achieved this alongside administering additional funding to help support further and higher education respond to the impact of Covid-19. The annual report and accounts were generally of an acceptable standard but some sections were incomplete and a key working paper relating to financial transactions was only made available to us after the audit commenced.</p> <p>Risk – The audit is delayed and SFC is unable to approve its annual report and accounts in accordance with its agreed timetable.</p>	<p>SFC should introduce additional steps to ensure the accounts presented for audit and the related working papers are complete.</p> <p><a href="#">Paragraph 21</a></p>	<p>Agreed</p> <p>Responsible officer: Assistant Director, Finance</p> <p>Agreed date: 31 March 2022</p>
<p><b>2. IFRS 9 accounting</b></p> <p>The annual report and accounts provided for audit did not reflect the adoption of International Reporting Standard (IFRS) 9.</p>	<p>Management should review its accounting policy for financial transactions annually and assess whether to apply IFRS 9 in future.</p> <p><a href="#">Exhibit 2</a></p>	<p>Agreed</p> <p>Responsible officer: Assistant Director, Finance</p> <p>Agreed date: 29 April 2022</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>SFC assessed the impact and concluded that the IFRS 9 adjustments and disclosures for its financial transaction balances is not material in the context of its accounts. On this basis, it did not apply IFRS 9 in preparing its accounts.</p> <p>Risk – SFC will receive higher levels of financial transactions funding in 2021/22. This may result in its accounting treatment no longer being appropriate.</p>		
<p><b>3. ESF accounting</b></p> <p>SFC’s accounts are prepared on an accruals basis but it continues to account for ESF income on a cash basis. This is because in SFC’s view the timing and receipt of this income is uncertain.</p> <p>In 2020/21 SFC received £2.3 million of ESF income. In July 2021, SFC received a further £2.6 million for a 2017/18 DSW claim. In our view, SFC’s accounting treatment of ESF income is no longer appropriate due to the increased number of claims approved.</p> <p>Risk – There is a risk that the income figure in the annual accounts is understated.</p>	<p>Management should carry out an annual assessment of the accounting treatment of ESF funding to ensure it is in accordance with the FReM.</p> <p><a href="#">Exhibit 2</a></p>	<p>Agreed</p> <p>Responsible officer: Assistant Director, Finance</p> <p>Agreed date: 31 March 2022</p>
<p><b>4. General ledger user access</b></p> <p>Our testing confirmed that management review general ledger access rights once a year.</p> <p>Risk – There is a risk that inappropriate access to the general ledger is not identified on a timely basis.</p>	<p>SFC should ensure senior officers review access to the general ledger on a more regular basis throughout the year.</p> <p><a href="#">Paragraph 40</a></p>	<p>Agreed – this will be carried out twice a year and when there are changes in the team</p> <p>Responsible officer: Assistant Director, Finance</p> <p>Agreed date: 29 October 2021</p>

Issue/risk	Recommendation	Agreed management action/timing
<p><b>5. Financial sustainability</b></p> <p>Financial forecast returns from colleges and universities allow SFC to build a picture of the financial health of the sectors. This informs its own financial plans and in turn helps it to support colleges and universities effectively.</p> <p>Returns usually include financial projections for the current academic year and following three years. The most recent returns have covered shorter periods, reflecting uncertainty over the longer-term impact of Covid-19.</p> <p>Risk – SFC does not have sufficient information to support a longer-term view of its financial position, and that of the sectors, and its options for future funding.</p>	<p>SFC should continue working with colleges and universities to produce longer-term financial forecasts. It should use these forecasts and any multi-year funding assumptions and commitments from the Scottish Government to develop SFC’s longer-term financial planning.</p> <p><a href="#">Paragraph 59</a></p>	<p>Agreed</p> <p>Responsible officer: Assistant Director, Institutional Sustainability &amp; Governance</p> <p>Agreed date: 29 October 2021</p>
<p><b>6. Performance report</b></p> <p>The performance report should provide information on SFC’s main objectives and the principal risks faced. It should provide a fair, balanced and understandable analysis of SFC’s performance as well as helping stakeholders understand the financial statements.</p> <p>SFC used the dispensation in the 2020/21 FReM and opted not to include a performance analysis in its annual report. The performance summary meets the requirements. It provides high-level information on SFC’s performance in 2020/21.</p> <p>Risk – SFC does not provide users of the annual report</p>	<p>SFC should resume its focus on the performance report to ensure it provides a comprehensive picture of how it has applied funds and what it has achieved.</p> <p><a href="#">Paragraph 64</a></p>	<p>We will continue to develop our approach to the performance report, drawing on best practice and guidance, to ensure that the report provides a comprehensive picture of how SFC has applied its funds throughout the year and the impact that has been achieved, including the contribution to the Scottish Government’s national priorities and our own Strategic Framework objectives.</p> <p>Responsible officer: Assistant Director, Strategy</p> <p>Agreed date: 31 May 2022</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>and accounts with a clear analysis of its performance.</p>		
<p><b>7. Cyber-security</b></p> <p>SFC received an external assessment in 2020/21 as part of the Cyber Essentials Plus accreditation process. The assessment identified some internal and external vulnerabilities.</p> <p>Risk – A cyber attack could disrupt SFC’s key financial systems and lead to loss of data with financial and reputational consequences.</p>	<p>SFC should address the issues identified in the Cyber Essential Plus assessment and continue to work towards achieving this accreditation.</p> <p><a href="#">Paragraph 68</a></p>	<p>Cyber security is recognised within SFC’s strategic risk register and we will be supported further via the introduction of a focused IT risk register. This comes from our plans to enhance our overall IT governance and strategy. As a top priority we will be undertaking the Cyber Essentials Plus accreditation at the earliest opportunity.</p> <p>Responsible officer: Chief Information Officer</p> <p>Agreed date: 29 October 2021</p>
<p><b>8. Performance reporting</b></p> <p>An annual performance report is provided to the board summarising the performance of colleges, universities and the sectors using performance measures set out in the strategic framework document.</p> <p>This was due to be presented at the August 2020 board meeting but was postponed due to Covid-19. It has not yet been presented to the board.</p> <p>Risk – SFC does not effectively scrutinise college and university performance.</p>	<p>SFC should ensure it reports to the board on sector performance to enable effective scrutiny of college and university performance.</p> <p><a href="#">Paragraph 74</a></p>	<p>We plan to provide the performance report to the Board at its November 2021 strategy meeting.</p> <p>Responsible officer: Assistant Director, Strategy</p> <p>Agreed date: 30 November 2021</p>

## Follow-up of prior year recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p><b>9. Workforce capacity</b></p>	<p>SFC should continue to develop its workforce plan</p>	<p>In progress – SFC is working to ensure it has sufficient</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>There are increasing demands on SFC's resources. This includes work to support the Enterprise and Skills Strategic Board, preparing for the implications of EU withdrawal and administering European funding to colleges. More recently, the response to the impact of Covid-19 has brought significant, additional pressures to SFC and its staff. SFC is continuing to develop its workforce plan and high-level discussions are taking place with the Scottish Government on the optimum resources required to deliver its increasing workload.</p> <p>Risk – Workforce decisions are not coordinated leading to decisions in one area having unintended consequences in another.</p>	<p>with a focus on ensuring it has sufficient resources to support its new Strategic Framework.</p>	<p>capacity across the organisation to deliver its objectives. It is aiming to fill the vacant posts in its new structure during 2021/22.</p> <p><a href="#">Paragraphs 44-46</a></p> <p>In progress – to be aligned with our new Strategic Framework.</p> <p>Responsible officer: Chief Executive</p> <p>Revised date: 31 March 2022</p>

# Appendix 2. Significant audit risks

The table below sets out the audit risks we identified on the 2020/21 audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the financial statements and those relating to our wider responsibility under the [Code of Audit Practice 2016](#).

## Risks of material misstatement in the financial statements

Audit risk	Assurance procedure	Results and conclusions
<p><b>1. Risk of material misstatement due to fraud caused by the management override of controls</b></p> <p>International Auditing Standards require that audits are planned to consider the risk of material misstatement in the financial statements caused by fraud, which is presumed to be a significant risk in any audit. This includes the risk of fraud due to management override of controls.</p>	<p>Testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Testing of accruals and prepayments.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p><b>Results:</b> Our testing did not identify any issues.</p> <p><b>Conclusion:</b> Satisfactory</p>
<p><b>2. Risk of material misstatement caused by fraud in expenditure</b></p> <p>As most public-sector bodies are net expenditure bodies, the risk of fraud is more likely to occur in expenditure.</p> <p>The risk of fraud over expenditure exists in SFC due to the high value payments is makes to colleges and universities. SFC also made additional payments to colleges and universities in 2020/21 to</p>	<p>Testing of expenditure transactions focusing on the areas of greatest risk.</p> <p>Substantive cut-off testing of expenditure, including significant Covid-19 payments, to ensure it is recognised in the correct financial year.</p>	<p><b>Results:</b> We re-assessed this risk before our financial statements audit and decided to rebut it. This is because the main elements of expenditure for SFC are funding to colleges and universities through grant payments that can be agreed to funding letters and there is a separate risk for grant payments to institutions (see risk 3).</p> <p><b>Conclusion:</b> Satisfactory</p>

Audit risk	Assurance procedure	Results and conclusions
<p>mitigate the impact of Covid-19. This places pressure on SFC to ensure funding is allocated in line with requirements.</p> <p>There is a risk that expenditure may be misstated resulting in a material misstatement in the financial statements.</p>		
<p><b>3. Grant payments to colleges and universities</b></p> <p>The main activity of SFC is the award and payment of grants to colleges and universities.</p> <p>Due to the complexities around different year end dates and re-profiling of budgets, there is a risk that grants paid to institutions are incorrectly recorded in the financial statements.</p>	<p>Testing of grant funding controls.</p> <p>Substantive testing of formula-based grant awards to individual bodies.</p> <p>Testing of grant commitments at the year end.</p> <p>Substantive cut-off testing of grant payments to ensure they are recognised in the correct financial year.</p>	<p><b>Results:</b> We found no issues from our testing of grant funding controls.</p> <p>We found no misstatements of grant payments to institutions from our sample testing of in year grant payments and commitments relating to the remainder of the academic year 2020/21. This testing covered additional funding relating to Covid-19 support.</p> <p>We found no issues from our cut-off testing of grant payments.</p> <p><b>Conclusion:</b> Satisfactory</p>

### Risks identified from the auditor's wider responsibility under the Code of Audit Practice

Audit risk	Assurance procedure	Results and conclusions
<p><b>4. Financial sustainability</b></p> <p>SFC and the colleges and universities it funds face significant financial pressures including the ongoing impact of Covid-19, increasing pay and pension costs, and the loss of European funding streams due to EU withdrawal.</p> <p>There is a risk that SFC does not have the information available to support a longer-</p>	<p>We reviewed SFC's progress in preparing medium to long-term financial plans for the further and higher education sectors.</p> <p>We considered SFC's arrangements for monitoring and reporting on the financial health of institutions.</p> <p>We reviewed updates on SFC's work with colleges' and universities' relationship with the EU.</p>	<p><b>Results:</b> We concluded that SFC continues to provide support to colleges and universities in managing risks associated with Covid-19 and EU withdrawal. SFC published a number of reports during 2020/21 that provide a useful oversight of the sectors' financial position.</p> <p>Uncertainty over the medium-term financial impact of Covid-19 has delayed SFC's</p>

Audit risk	Assurance procedure	Results and conclusions
<p>term view of its financial position and its options for future funding.</p>		<p>progress in preparing longer-term financial plans.</p> <p><b>Conclusion:</b> Ongoing – see <a href="#">Action Plan point 5</a></p>
<p><b>5. Cyber security</b></p> <p>Organisations are increasingly threatened by cyber-attacks as evidenced by recent incidents affecting public bodies. SFC is working to strengthen its cyber security arrangements including recommendations from a recent internal audit report and seeking Cyber Essentials Plus accreditation.</p> <p>There is a risk that a cyber-attack could disrupt SFC’s key financial systems and lead to loss of data with financial and reputational consequences.</p>	<p>We reviewed SFC’s progress in achieving Cyber Essentials Plus Accreditation.</p> <p>We reviewed the action taken on the internal audit recommendations.</p> <p>We reviewed actions taken by SFC to mitigate the risks of cyber security and failure of IT systems.</p>	<p><b>Results:</b> SFC did not achieve Cyber Essentials Plus Accreditation during 2020/21 and has not completed the recommendations in the internal audit IT Risk Assessment report.</p> <p>SFC is planning to take action in 2021/22 to mitigate the risk of cyber security and failure of IT systems such as penetration testing and introducing an IT risk register.</p> <p><b>Conclusion:</b> Unsatisfactory – see <a href="#">Action Plan point 7</a></p>
<p><b>6. Workforce capacity</b></p> <p>There are increasing demands on SFC’s resources. This includes work to support the Enterprise and Skills Strategic Board, implications of EU withdrawal, and administering European funding to colleges and allocation of Covid-19 funding.</p> <p>There is a risk that SFC does not have adequate resources to carry out its core functions and meet the objectives set out in its strategic plan, the Strategic Framework 2019-2022.</p>	<p>We reviewed SFC’s workforce plan.</p> <p>We considered how resources have been reprioritised across SFC in response to COVID-19.</p> <p>We reviewed the early severance packages approved in 2020/21 in terms of the basis for related decisions and how they are reflected in SFC’s annual report and accounts.</p>	<p><b>Results:</b> SFC has appropriate plans to make the changes required to build capacity and ensure it has sufficient resources for investment in new skills.</p> <p>Our testing of voluntary severance packages did not identify any issues and the packages tested complied with value for money considerations.</p> <p><b>Conclusion:</b> Satisfactory</p>

# Appendix 3. Summary of 2020/21 national performance reports

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## April

[Affordable housing](#)

## June

[Highlands and Islands Enterprise: Management of Cairngorm mountain and funicular railway](#)

[Local government in Scotland Overview 2020](#)

## July

[The National Fraud Initiative in Scotland 2018/19](#)

## January

[Digital progress in local government](#)

[Local government in Scotland: Financial overview 2019/20](#)

## February

[NHS in Scotland 2020](#)

## March

[Improving outcomes for young people through school education](#)

# Scottish Funding Council

## 2020/21 Annual Audit Report

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